

ORIGINAL

DIVISION OF CONSUMER ADVOCACY  
Department of Commerce and  
Consumer Affairs  
335 Merchant Street, Room 326  
Honolulu, Hawaii 96813  
Telephone: (808) 586-2800

BEFORE THE PUBLIC UTILITIES COMMISSION  
OF THE STATE OF HAWAII

PUBLIC UTILITIES  
COMMISSION

2009 JAN 30 P 3:26,

FILED

In the Matter of the Application of )  
)  
PUBLIC UTILITIES COMMISSION )  
)  
Instituting a Proceeding to Investigate )  
Implementing a Decoupling Mechanism for )  
Hawaiian Electric Company, Inc., Hawaii )  
Electric Light Company, Inc., and Maui )  
Electric Company, Limited. )

DOCKET NO. 2008-0274

**DIVISION OF CONSUMER ADVOCACY'S**  
**HECO/MECO/HELCO RATE ADJUSTMENT MECHANISM "RAM" CONCEPTUAL**  
**FRAMEWORK PROPOSAL**

Pursuant to the Stipulated Regulatory Schedule approved in Order Approving, with Modifications, Stipulated Procedural Order Filed on December 26, 2008, the Division of Consumer Advocacy submits its **HECO/MECO/HELCO RATE ADJUSTMENT MECHANISM "RAM" CONCEPTUAL FRAMEWORK PROPOSAL** in the above docketed matter.

DATED: Honolulu, Hawaii, January 30, 2009.

Respectfully submitted,

By Catherine P. Awakuni  
CATHERINE P. AWAKUNI  
Executive Director  
DIVISION OF CONSUMER ADVOCACY

BEFORE THE PUBLIC UTILITIES COMMISSION  
OF THE STATE OF HAWAII

In the Matter of )  
 )  
PUBLIC UTILITIES COMMISSION )  
 )  
Instituting a Proceeding to Investigate )  
Implementing a Decoupling Mechanism for )  
Hawaiian Electric Company, Inc., Hawaii )  
Electric Light Company, Inc., and )  
Maui Electric Company, Limited. )

Docket No. 2008-0274

**CONSUMER ADVOCATE'S HECO/MECO/HELCO RATE ADJUSTMENT  
MECHANISM "RAM" CONCEPTUAL FRAMEWORK PROPOSAL**

**Consumer Advocate Discussion**

**January 30, 2009**

## **I. INTRODUCTION.**

On October 20, 2008, the State of Hawaii<sup>1</sup> and the HECO Companies<sup>2</sup> entered into a comprehensive agreement, generally identified as the Hawaii Clean Energy Initiative ("HCEI") Agreement,<sup>3</sup> designed to move the State away from imported fossil fuels and toward renewable energy. This agreement also included commitments to encourage the Commission to modify the traditional ratemaking model by implementing (i) revenue decoupling, (ii) piecemeal surcharge rate recovery of selected Clean Energy Infrastructure ("CEIS") projects and (iii) a formula rate adjustment mechanism ("RAM") allowing rates to increase between general rate cases. Thus, a three-tiered enrichment of traditional test year regulation is presently under consideration by the Commission in connection with the Clean Energy Initiative. The challenge at this time is to support continued progress toward clean energy goals while encouraging efficient cost management by the utilities and maintaining just and reasonable utility prices for consumers.

Subject to Commission approval as discussed in the HCEI Agreement, the decoupling of sales volumes from utility revenue collections is scheduled to occur at the time of implementation of interim rates ordered by the Commission in the pending HECO rate case. Decoupling by itself is fully compensatory to the utilities for changes

---

<sup>1</sup> The Governor of the State of Hawaii, the State of Hawaii Department of Business, Economic Development and Tourism, and the State of Hawaii Division of Consumer Advocacy of the Department of Commerce and Consumer Affairs ("Consumer Advocate").

<sup>2</sup> Hawaiian Electric Company, Inc. ("HECO"), Hawaii Electric Light Company, Inc. ("HELCO"), and Maui Electric Company, Limited ("MECO"), collectively the "HECO Companies".

<sup>3</sup> Energy Agreement among the State of Hawaii, Division of Consumer Advocacy of the Department of Commerce & Consumer Affairs, and Hawaiian Electric Companies, generally identified as the "HCEI Agreement".

in utility sales that may result from customer conservation or non-utility energy resource additions. Thus, the HECO Companies will be fully insulated from any risks arising from volume declines, whether directly resulting from HCEI-related activity or the ongoing effects of the national economic recession.<sup>4</sup>

Renewable Energy Infrastructure Program ("REIP") Surcharge proposals have been considered by the Commission in Docket Nos. 2007-0008 and 2007-0416 and in the pending Advanced Metering Infrastructure ("AMI") Docket No. 2008-0303. Through separate proposed surcharges, all costs arising from Commission approved REI Programs would receive preferential recovery without the need for or lag associated with traditional rate case procedures. For example, in the pending AMI proceeding, HECO has sought recovery of the Companies' incremental costs associated with the AMI Project through the pending REIP Surcharge or through an AMI surcharge mechanism that may be implemented by the Commission in the AMI proceeding.<sup>5</sup>

---

<sup>4</sup> In its pending rate case, HECO Docket No. 2008-0083, the Company has submitted updated filing calculations indicating substantial downward adjustments to its originally filed 2009 sales forecast, reflecting reduced usage per electric customer, apparently due to the combined effects of price elasticity after record ECAC charges, economic pressures caused by the recession and ongoing consumer efforts to conserve energy. Rather than directly seeking modification of its pending rate case, HECO has offered to forego updating rate case sales because the decoupling mechanism and associated Revenue Balancing Account ("RBA") will prospectively insulate HECO from sales fluctuations in a fully compensatory manner. (See HECO Update T-1, at pages 4-5)

<sup>5</sup> According to HECO's AMI application, the AMI Project involves the incurrence of substantial upfront costs that generally will not be offset by quantifiable benefits in the short term, but rather by the realization of longer term benefits far into the future. HECO seeks to address this "imbalance" by more closely matching project-related cost incurrence (i.e., net of quantifiable benefits) with cost recovery by flowing the incremental revenue requirement impacts of the AMI Project through an adjustment clause. HECO claims that the cost recovery support provided by the REIP Surcharge will help the HECO Companies raise capital for renewable infrastructure projects, without degrading credit quality or increasing the cost of capital. Such an adjustment clause recovery scheme would side-step traditional ratemaking, under which the Companies

HECO has sought to supplement traditional ratemaking with other ratemaking tools, such as the proposed REIP Surcharge, which would allow cost recovery to begin as soon as new facilities go into service.<sup>6</sup>

The RAM, as included in the HCEI Agreement, adds a third layer of enrichment to traditional test year regulation. Through the RAM, the decoupled and otherwise “fixed” level of revenues can be systematically increased between rate case test years by application of price level indices to groups of costs that were defined in the prior rate cases. For HECO, this may entail formula-driven rate increases effective in early 2010 and again in early 2011 that would build upon the outcome of the pending 2009 HECO rate case. A similar pattern of MECO and HELCO rate case filings is planned, followed by subsequent RAM revenue adjustments building upon the ordered revenue requirement outcomes of such rate cases.

The combined effect of revenue decoupling, REIP revenue surcharges, RAM inflation-indexed rate changes, and pending and scheduled rate cases is a series of systematic and potentially significant rate increases for electric customers over the next several years – with much of the cumulative rate increases occurring via formulistic devices intended to receive limited formal regulatory review.

After carefully reviewing the HCEI Agreement and meeting with representatives of the HECO Companies on multiple occasions, the Consumer Advocate has prepared a proposed decoupling/RAM framework, as presented herein, to define and implement

---

would begin recovering costs incurred to install new infrastructure through the processing of general rate cases proceedings.

<sup>6</sup> HECO Companies' Application, AMI Docket No. 2008-0303, Section XI.A.3. Need for Timely Cost Recovery, pp. 69-71.

a formulistic rate adjustment method and offers additional ratepayer protections. For ease of discussion, we refer in this document to the combination of decoupling with a RBA and periodic formula-driven changes to authorized revenues as a "Rate Adjustment Mechanism" or "RAM". The Consumer Advocate is mindful of the fact that the Commission has not authorized any decoupling mechanism and that the final RAM design should complement the decoupling method ultimately adopted by the Commission. In order to comply with the HCEI Agreement, the Consumer Advocate proposes the following RAM framework, subject to periodic review and evaluation, for implementation in conjunction with decoupling and deferral accounting for each of the HECO Companies, pursuant to a predefined rate case filing and RAM implementation schedule. The RAM framework would extend to each of the HECO Companies' next round of rate cases, at which time, upon Commission review and evaluation, it may be extended, terminated or modified based upon evidence presented in those rate case proceedings. It is the Consumer Advocate's belief that RAM and the other extraordinary, non-traditional regulatory relief measures set forth in the HCEI Agreement are needed and can only be justified by the significant commitments made by the HECO Companies to support the Clean Energy Initiative and, upon substantial completion of such efforts, regulation should return to the traditional framework that has served the public interest well for many years.

The RAM outline set forth herein is a discussion draft and does not represent the final position of the Consumer Advocate, which is still under formation through ongoing discussions with the parties to this proceeding. It is offered to stimulate dialogue around the many complex issues raised by substitution of formula ratemaking in place of more

traditional processes. The Consumer Advocate reserves the right to modify any positions set forth herein and is prepared to explain the basis for these proposals with a goal of achieving consensus with the HECO Companies so that a joint RAM procedure might be offered for consideration by the Commission.

## **II. TERM AND TRIAL IMPLEMENTATION.**

A conservatively scoped RAM shall be implemented using an initial two year term for HECO, with revenue adjustments on January 1, 2010 and January 1, 2011; a three year term for HELCO with adjustments at January 1, 2010, 2011 and 2012; and a four year trial term for MECO with revenue adjustments January 1, 2010, 2011, 2012 and 2013. These revenue adjustments are to be implemented by revision to the decoupling RBA that has been established to implement decoupling of utility sales from revenues. These RAM intervals are designed to coincide with foundational rate case proceedings using a 2009 test year for all three utilities, followed by staggered subsequent rate cases for HECO, HELCO and MECO using test years of 2011, 2012 and 2013, respectively. The HECO 2011 rate case shall serve as the forum for any HECO proposed extension or modification of the RAM procedures and for consideration of any changes proposed by the Consumer Advocate or other parties. The HECO Companies shall bear the burden of proof regarding potential continuation of RAM after the second round of base rate cases.

## **III. CONSERVATISM.**

Conservatism in the design and implementation of the initial RAM implementation period is essential for several reasons:

- A. Significant risks are shifted to ratepayers as a result of the implementation of formulaic rate adjustments between formal rate case test years without detailed, formal regulatory review.
- B. RAM rate changes are based upon unproven assumed correlations between inflation indices and utility costs. Historical trends in utility expenses and rate base investment may be useful in estimating past cost and productivity trends, but history does not necessarily predict future cost and productivity trends. RAM adjustments represent revenue changes to account for presumed earnings attrition, even though no showing has been made by the HECO Companies that attrition will occur in the future.
- C. Decoupling alone may yield potentially significant periodic rate increases to sustain existing utility margin revenue levels and these rate increases would be amplified by RAM-driven increases in authorized revenue levels, creating the potential for unreasonable ratepayer impacts while utility shareholders are insulated from all energy market risks and are assured risk free future revenue growth.
- D. RAM formula specification risks are amplified for the HECO Companies under the HCEI Agreement because of the multiple new piecemeal cost recovery mechanisms that are specified in the HCEI Agreement for treatment of REIP, Purchased Power Adjustment ("PPA") and AMI costs that require careful integration with traditional rate case and RAM cost recovery processes.



For all of these reasons, the Consumer Advocate's proposed RAM is narrowly prescribed to apply generalized inflation indices to only certain non-labor operating expenses, contractual wage rate changes to labor costs, certain known and measurable changes to depreciation/annualization expense, and Commission approved overall Rate of Return ("ROR") rates to defined net capital investments that exceed ongoing depreciation recoveries. Moreover, the proposed RAM calculations will apply only to base costs that are not eligible for recovery though any special surcharge or cost recovery tariffs. Additionally, the RAM shall be subject to earnings monitoring and sharing to protect ratepayers from unreasonable financial outcomes and, as noted previously, shall be designated as an initial implementation of the program, subject to formal review in each utility's next post-2009 test year rate case. All parties reserve the right to initiate formal rate proceedings to replace and terminate RAM at any time on a schedule other than as planned herein.

#### IV. EARNINGS MONITORING AND SHARING.

Earnings monitoring and sharing will be employed for four purposes under the Consumer Advocate's RAM proposal:<sup>7</sup>

- A. As a backstop for the high level of uncertainty and increased ratepayer risks associated with implementation of new RAM index-driven revenue increase procedures,

---

<sup>7</sup>

According to its responses to Informal CA-IR-15 and CA-IR-22, the HECO Companies do not believe that earnings monitoring or sharing are needed in connection with RAM implementation.

- B. To prevent excessive cumulative cost recoveries (i.e., excessive revenues) under RAM and the various new surcharge mechanisms envisioned by the HCEI Agreement and other proceedings,
- C. To provide a periodic filing and forum for the review of financial results achieved by each utility under RAM as an aid to regulatory understanding of whether RAM is reasonably balancing the interests of the utilities and ratepayers, and
- D. To explicitly reward utility performance with a sharing of any higher returns on investment if costs are successfully contained below RAM escalation rate expectations.

Under the proposed earnings sharing, the utility is afforded a modestly expanded Return on Equity ("ROE") opportunity by retaining for its shareholders a portion of all returns above authorized levels of ROE between test years. This explicit return incentive is designed to encourage management efficiency, while imposing an ROE sharing constraint upon achievable earnings to prevent abusive outcomes if the prescribed calculations of RAM, REIP and other ratemaking devices prove to be imprecisely specified. Notably, in its Application in Docket No. 99-0396, HECO also proposed a "Performance Based Regulation" or "PBR" plan that included an index-driven price cap form of regulation and an earnings sharing mechanism similar to the earnings sharing approach being proposed herein.<sup>8</sup>

<sup>8</sup>

See HECO Application in Docket No. 99-0396, page 7 at 2. EARNINGS SHARING MECHANISM. In its PBR Application, HECO proposed earnings sharing of earnings on a 50/50% basis with customers, outside of a "deadband" of plus and minus 100 basis points (one percent) around the Commission approved ROE.

Earnings, as measured by ROE, achieved by each of the HECO Companies, are to be calculated on a regulatory basis of accounting for each calendar year that includes RAM revenues. Ratepayers would then be credited with the revenue equivalent of ROE levels actually achieved within the following illustrative sharing layers (after removal of any prior period RAM adjustments and routinely disallowed costs)<sup>9</sup>:

ROE below 9.0%	Retained entirely by shareholders – no customer credits
ROE from 9.0% to 10.0%	25% share credit to customers
ROE from 10.0% to 12.0%	50% share credit to customers
All ROE over 12.0%	90% share credit to customers

The proposed earnings sharing grid is intentionally asymmetrical, with no surcharges to customers if achieved ROE is below 9.0 percent, in recognition of the considerable financial benefits afforded the utilities through the trio of regulatory enhancements being offered in the form of decoupling, CEI program surcharges and

<sup>9</sup> The proposed earnings sharing grid was developed in the context of HECO's recent regulatory activity. In both its last rate case (Docket No. 2006-0386) and the pending rate case (Docket No. 2008-0083), HECO recommended a return on equity of 11.25%. For settlement purposes in Docket No. 2006-0386, the Parties agreed to an ROE of 10.7%. This ROE range (i.e., 10.7% to 11.25%) presumed the continuation of business as usual and did not contemplate the significant shifting of risk to ratepayers that will result from the combination of decoupling, REIP/CEI surcharges and RAM. Consequently, the Commission may desire to revise this sharing grid based on a more current assessment of relative ROE requirements under the new HCEI regulatory framework.

RAM formula-driven rate increases. The proposed sharing grid also recognizes the significant shifting of cost exposure to ratepayers without the need for the utilities to file a general rate case and that the utilities are not bound by any moratorium precluding the filing of traditional rate cases, if deemed necessary.

Earnings monitoring and sharing reports will be prepared by the HECO Companies and submitted on an annual basis as described herein, retaining all ratemaking adjustments, capital ratios and updating the average rate base determinations from the most recently completed rate case proceeding.<sup>10</sup> Any recorded revenues arising from out of period adjustments or prior year earnings credits shall be identified and removed in preparing earnings sharing calculations. The earnings monitoring and sharing report shall be accompanied by detailed supporting workpapers, showing the quantification of achieved earnings and each ratemaking adjustment embedded therein.

If a RAM year is also a rate case test year, the RAM revenues authorized for that year should be deemed interim, and subject to refund if later found to be excessive in the final rate order for that year. No further interim rate relief or Statement of Probable Entitlement is required for that year due to the already implemented RAM interim increase for that test year. Through this process of interim rate designation, revenues

---

<sup>10</sup> Ratemaking adjustments include expenses removed in the Company's initial filing as well as all ordered expense disallowances. Rate base elements and methodologies are defined by the most recent rate case, but shall be updated to reflect current average investment balances for the year. Capital ratios and costs rates will be retained per the most recent rate case, but synchronized interest will be updated using methods employed in that last rate case. The resulting achieved return on equity at authorized revenue levels shall serve as the basis for any earnings credits to the RBA, after factoring up post-tax income amounts to pretax revenue equivalent values. Detailed supporting workpapers and electronic files should be submitted coincident with all filings made by the utilities.

collected by the utilities would be forced into balance with Commission approved rate case results coincident with the conduct of each future formal rate case.

**V. PROCEDURAL PROVISIONS.**

*Procedural provisions for RAM rate/revenue adjustments are important to insure compliance with prescribed regulatory policies and effective Commission oversight. Continuous deferral accounting in the form of a RBA shall be used to ensure that actual revenue billings are effectively "decoupled" from authorized revenue levels, commencing with and based upon the date and amounts of interim rates approved for each of the HECO Companies associated with the respective 2009 test year rate cases.*

Upon issuance of final rate orders in the 2009 test year rate cases, the authorized revenues for RBA reconciliation shall be restated to final Commission approved levels. RAM rate/revenue adjustments will then be employed to determine authorized revenue changes for each post test year period. Annual earnings sharing revenue credits, if any, will be posted directly to the RBA account and considered as part of the reconciliation of actual versus authorized revenues used each year to determine the rate/revenue adjustments. Any regulatory adjustments imposed by the Commission can be applied to the RBA account at any time, providing a vehicle for continuing oversight and of approved revenue levels, which may be particularly important if limited Commission and Consumer Advocate time and resources are available for review of the continuum of rate cases, HCEI program filings and RAM adjustment filings to occur under the procedures outlined in the HCEI Agreement and herein.

Each utility will submit periodic filings to calculate a single revenue balancing surcharge that will collect or return the cumulative difference between actual and authorized revenues for the previous accounting period, less any earnings-sharing revenue credits, with adjustments to the prospective surcharge rates pursuant to the following procedures:

- A. An annual filing for each HECO Company shall be submitted to the Commission, the Consumer Advocate and each party to that utility's most recent rate case by February 28 of each year containing the following information:
  - 1. Reconciliation calculations for the prior period actual recorded versus authorized revenue amounts,<sup>11</sup> for all periods when a revenue balancing account was in place, with supporting statistical sale data and supporting documentation for the cumulative under or over recovery of revenue to be collected/returned prospectively.
  - 2. Calculations of proposed RAM adjustments to establish revised authorized revenues for the current year, with all supporting exhibits and workpapers concurrently filed with the Commission.
  - 3. Calculations of the achieved ROE for the prior calendar year, presented on a regulatory basis of accounting using actual average rate base investment levels, the Commission authorized capital ratios and cost rates, and all other ratemaking adjustments

---

<sup>11</sup> The reconciliation would apply only to the base revenues being tracked through the decoupling RBA and not revenues that are separately recovered and reconciled for ECAC, PPA, CEIS surcharge or DSM/IRP, or Pension/OPEB recovery mechanisms.

applicable to that year, along with the calculations supporting any earnings sharing revenue credits owed to customers, pursuant to Section IV. above.

4. Calculations supportive of prospective revenue changes needed to accurately revise the revenue requirement to reflect the direct result of any changes in tax legislation or regulation having an estimated prospective annual impact upon prior year recorded utility revenues in excess of one-half of one percent (0.5%) of such revenues.
5. Submission of any prescribed service quality statistical reports for the prior calendar year.

B. Calculated RBA surcharge/credit rate changes by rate class are to be effective May 1 of the current year, using estimated KWH billing determinants for the remaining eight months of the current year.<sup>12</sup> To implement this provision, RAM formula-driven revenue changes are to be allocated to rate super-classes using the percentage distribution of revenue changes from the utility's most recent general rate case and variations in actual sales levels within a super-class are to create surcharge/credit rate effects within that class. Rate super-classes shall result from the combination of existing commercial rate classes into logical

---

<sup>12</sup>

In response to Informal CA-IR-19c, the HECO Companies suggest that "Periodic filings containing the calculated post test year revenue adjustments, rate design and tariff for each of the post test year rate changes will be made at least one month in advance of the proposed effective date of the post test year adjustments." A thirty-day review period by the Commission and the Consumer Advocate is expected to be insufficient, particularly in the context of potentially large revenue increases that may result from RAM implementation.

groups as appropriate. All decoupling/RAM RBA adjustments are to be implemented on a per KWH basis within each rate super-class.

- C. Due to the novel nature of the RAM, there is ongoing research with respect to the application of or compliance with Hawaii Revised Statutes, Chapter 269, and all other relevant statutes, administrative rules and directives, related to procedural matters including and not limited to notice to customers and requisite public hearings for proposed rate changes. This ongoing research will need to continue to insure that future revisions and/or versions of any proposed RAM comply with existing authoritative guidance and/or to determine what, if any, changes in the applicable statutes, administrative rules, or other guiding authoritative references are necessary.

#### **VI. INCEPTION AMOUNTS FOR RAM CALCULATION.**

Inception Amounts for RAM Calculation – Updated test year values, adjusted for anticipated sales volumes and the most recent fuel pricing, will create the cost pools and rate base investment balances to be used to determine interim rate calculations for the HECO Companies and to establish RAM base cost amounts by cost pool. These cost pools will be defined in each rate case to specifically exclude all expenses and rate base investments that are determined to be subject to any CEI Surcharge cost recovery mechanism, any existing cost tracking mechanism (e.g., ECAC, pensions/OPEBs) or otherwise not subject to inflationary adjustments. A HECO RAM shall be implemented to commence with a "base" year 2009 and with authorized revenue changes effective on January 1, 2010 and again at January 1, 2011, but with the corresponding rate



adjustments delayed to May 1 of each year so that the established revenue variance will be recovered over the subsequent eight months of the year. The 2011 RAM will define the interim rates for HECO's planned 2011 test year rate case and will be deemed interim and subject to refund and/or RBA balance adjustment if found excessive in the Commission final rate order.

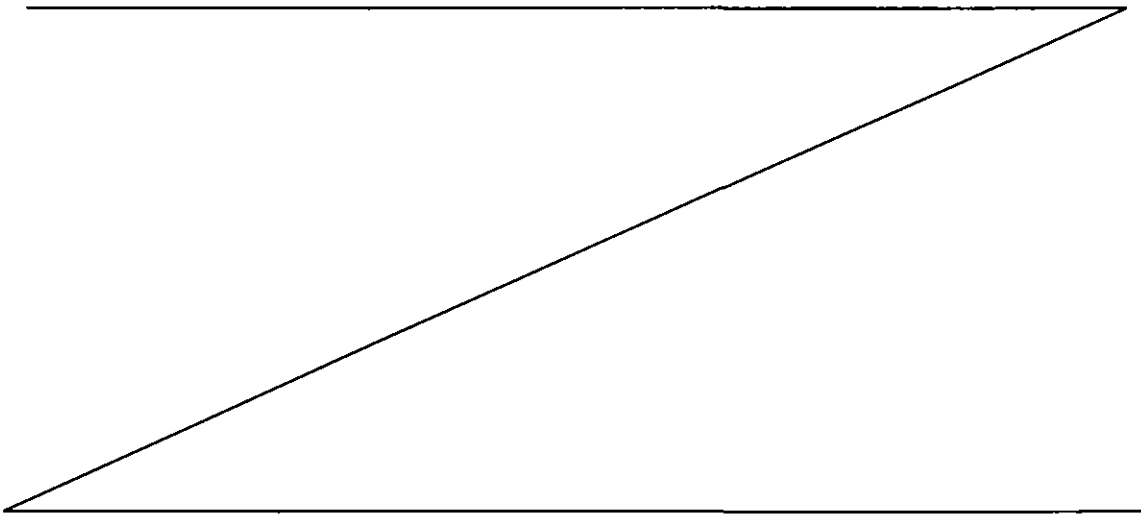
RAM inception amounts for MECO and HELCO will be developed in their 2009 rate cases. The RAM mechanism and deferral accounting will commence after interim rates are approved for both MECO and HELCO, using test year approved amounts and the procedures defined herein. MECO and HELCO shall implement a RAM revenue adjustment effective on January 1, 2010 for rate implementation May 1 of that year.

## **VII. RAM INCOME STATEMENT APPROACH.**

RAM Income Statement Approach – test year expenses that are not “tracked” shall be isolated into pools for RAM escalation. Non “tracked” expenses refers to all expenses other than those covered by a separate tracking mechanism such as fuel and purchased energy (ECAC recovered), purchased power (to be PPA recovered), IRP/DSM, pensions/OPEBs and REI Program costs eligible for REIP surcharge treatment.

- A. O&M Expenses that are not “tracked” shall be indexed in each subsequent year's RAM calculation to account for Wage and Non-wage price changes, net of productivity:

1. Union Wage ("BU") expense pool dollars are to be escalated at union contractual wage increase levels.<sup>13</sup> If wage contract rate changes have not been determined for the projected RAM period, union wages shall be changed by the most recent annual wage rate adjustment percentage applicable during the immediately preceding union contract period.
2. Non Bargaining Unit ("non-BU") Salaries are to be escalated at parity with union wages, as described in item (1) above.
3. Non-labor expenses (excluding tracked costs) are to be escalated at published Gross Domestic Product – Price Index ("GDP-PI") levels<sup>14</sup> for fourth quarter current period over fourth quarter prior year percentage rates of change.



<sup>13</sup> The wage escalation shall be weighted to reflect the number of months the increase will be effective during the RAM year.

<sup>14</sup> The U.S. Bureau of Economic Analysis ("BEA") publishes Gross National Product Price Indices for the fourth quarter of each calendar year in Table 1.1.4 of its National Income and Product Accounts Table. See:  
<http://www.bea.gov/national/nipaweb/TableView.asp?SelectedTable=4&Freq=Qtr&FirstYear=2006&LastYear=2008>.

4. A productivity offset of at least 0.76 percent is to be applied to the inflation escalation values set forth in A1 through A3, herein, to represent a target for HECO productivity improvements under incentive regulation.<sup>15</sup>
- B. "Tracked" O&M expenses that meet the definitional criteria to be recoverable under energy cost adjustment, renewable energy infrastructure, purchased power, IRP/DSM, pension costs, OPEBs or other separate surcharge mechanisms shall be excluded from all RAM calculations and adjustments on a consistently applied basis of accounting.
- C. Depreciation and amortization expense is to be based upon the prior year-end actual investment/annualization approach described in Section VIII.C.3, below. Annualized depreciation and amortization expense shall be compared to prior year recorded depreciation and amortization and the difference shall be included in calculating the required RAM revenue adjustment for the RAM period.

---

<sup>15</sup>

In its Application for Approval to Implement Performance Based Ratemaking in Docket No. 99-0396, HECO recommended use of the GDP-PI inflation factor recommended herein, offset by a "...productivity measure (or "X-factor")...based on the long run growth trends in total factor productivity ("TFP") and the input prices of the investor-owned electric utility industry and the U. S. Economy. The X-factor for the first plan period is 0.76%." If HECO has conducted and provides an updated TFP study for review and evaluation by the Commission and the participating Parties, the 0.76 percent productivity offset could be replaced by the more current factor approved by the Commission. According to its responses to Informal CA-IR-9 and CA-IR-18, the HECO Companies agree that a multi-year rate adjustment mechanism should strengthen efficiency incentives to utility management, but do not believe that any productivity offsets or stretch productivity targets are needed in connection with RAM implementation.

- D. Contributions In Aid of Construction ("CIAC") amortization shall be based on the prior year-end actual balance of CIAC substantially similar to depreciation and amortization expense, as further described in Section VIII.C.4 below.
- E. Payroll taxes to be escalated at composite wage rates (weighted BU and non-BU).
- F. Revenue taxes are to be added to all trackers and to RAM adjustments using composite effective revenue tax rates.

RAM adjustments for changes in expense amounts are re-based using updated, test year approved input values upon completion of scheduled base rate cases for each of the HECO Companies. Ratemaking conventions used for RAM adjustments shall be consistent with the corresponding regulatory methodologies employed in formal rate cases, in settlement documentation and/or formal Decisions and Orders issued by the Commission.

#### **VIII. RAM RATE BASE APPROACH.**

RAM Rate Base Approach – Rate base changes are to be accounted for using a simplified revenue requirement approach, inclusive of a pretax effective overall Rate of Return applied to estimated Net Plant in Service ("NPIS") changes, including components for changes in accumulated depreciation, CIAC and accumulated deferred income tax reserves, defined as follows. The Rate Base Revenue Requirement ("RBRR") RAM Adjustment Formula shall be:

$$\text{RBRR} = \text{ROR} * 50\% * \text{NPIS}$$

- A. The weighted average pretax<sup>16</sup> ROR shall be based upon the most recent rate case approved capital structure ratios and cost rates, including the Commission approved return on equity.<sup>17</sup>
- B. A fifty percent factor is applied to recognize average rate base test year ratemaking policies employed by the Commission.
- C. Projected NPIS additions shall be determined by the formula  $NPIS = PIS - CIAC - ANNDEP + CIACAMT - ADIT$  using the following procedures:
  - 1. Plant In Service ("PIS") investment additions for RAM adjustment shall be determined in two parts, including average "Baseline" PIS plus "Major Project" PIS.
    - a) Historical average completed gross plant investment, as closed to Account 101 in the immediately preceding five years (e.g., initial period would cover years 2004 through 2008), shall be analyzed to exclude major project investments that required CIS Dockets before the Commission, with the remaining project costs considered "baseline" plant investments. The resulting average "baseline" gross PIS plant additions are then utilized in

---

<sup>16</sup> A "pretax" ROR involves factoring up the weighted average cost of debt capital for revenue taxes and factoring up the weighted average cost of equity capital for both revenue taxes and income taxes. The resulting percentage can be used to translate each dollar of rate base investment into an equivalent revenue requirement amount.

<sup>17</sup> In its response to Informal CA-IR-19e, the Companies state, "The HECO Companies are not proposing revision of the cost of capital outside of periodic base rate cases at this time."

calculating RAM for each prospective year without price level escalation.

- b) Major projects that have been approved by Commission Order in a Capital Improvement Project ("CIP") Docketed proceedings and that have not previously been included in rate base, for which completion and closing into PIS is virtually certain within the first half of the projected RAM period, are to be combined with the average "baseline" plant additions in part (a). The inclusion of such CIP projects in plant in service for RAM purposes does not foreclose any future review or evaluation of the reasonableness of the final cost of an individual project in future rate case proceedings and subsequent adjustments to the RBA to restate authorized revenue levels.
- 2. CIAC shall be estimated using techniques substantially similar to the determination of PIS, segregated between "Baseline" and "Major Project" CIAC.
  - 3. Estimated Annualized depreciation expense ("ANNDEP") shall be determined by applying Commission approved accrual rates to the prior year-end actual Plant in Service balances by Account. ANNDEP is subtracted from NPIS to recognize that ongoing recovery of annual depreciation expense will serve to offset the continuing additions of new NPIS throughout the RAM period.

4. Estimated annual CIAC amortization ("CIACAMT") shall be determined using the standard Commission approved amortization methodology. The amount included in NPIS shall be quantified in a manner substantially similar to ANNDEP.
  5. Estimated incremental Accumulated Deferred Income Taxes ("ADIT") arising from the depreciation timing differences applicable to Gross PIS changes in items (1) and (2) above shall be calculated using composite State and Federal income tax rates.
- D. Changes in fuel inventories, working cash, customer advances/deposits and other elements of rate base are to be ignored to simplify RAM calculations.

RAM adjustments for changes in rate base are to be re-calculated using updated, test year approved input values upon completion of scheduled base rate cases for each of the HECO Companies. Ratemaking conventions used for RAM adjustments shall be consistent with the corresponding regulatory methodologies employed in formal rate cases, in settlement documentation and/or formal Decisions and Orders issued by the Commission.

**CERTIFICATE OF SERVICE**

I hereby certify that a copy of the foregoing **DIVISION OF CONSUMER ADVOCACY'S HECO/MECO/HELCO RATE ADJUSTMENT MECHANISM "RAM" CONCEPTUAL FRAMEWORK PROPOSAL** was duly served upon the following parties, by personal service, hand delivery, and/or U.S. mail, postage prepaid, and properly addressed pursuant to HAR § 6-61-21(d).

DEAN MATSUURA  
MANAGER  
REGULATORY AFFAIRS  
HAWAIIAN ELECTRIC COMPANY, INC.  
HAWAII ELECTRIC LIGHT COMPANY, INC.  
MAUI ELECTRIC COMPANY, LTD.  
P.O. Box 2750  
Honolulu, HI 96840-0001

1 copy  
by hand delivery

JAY IGNACIO  
PRESIDENT  
HAWAII ELECTRIC LIGHT COMPANY, INC.  
P. O. Box 1027  
Hilo, HI 96721-1027

1 copy  
by U.S. Mail

EDWARD L. REINHARDT  
PRESIDENT  
MAUI ELECTRIC COMPANY, LTD.  
P. O. Box 398  
Kahului, HI 96732

1 copy  
by U.S. Mail

THOMAS W. WILLIAMS, JR., ESQ.  
PETER Y. KIKUTA, ESQ.  
DAMON L. SCHMIDT, ESQ.  
GOODSILL, ANDERSON QUINN & STIFEL  
Alii Place, Suite 1800  
1099 Alakea Street  
Honolulu, Hawaii 96813

1 copy  
by hand delivery

Counsel for HECO, HELCO, and MECO



RANDALL J. HEE, P.E.  
PRESIDENT AND CEO  
KAUAI ISLAND UTILITY COOPERATIVE  
4463 Pahe'e Street, Suite 1  
Lihue, Hawaii 96766-2000

1 copy  
by U.S. Mail

TIMOTHY BLUME  
MICHAEL YAMANE  
KAUAI ISLAND UTILITY COOPERATIVE  
4463 Pahe'e Street, Suite 1  
Lihue, Hawaii 96766-2000

1 copy  
by U.S. Mail

KENT D. MORIHARA, ESQ.  
KRIS N. NAKAGAWA, ESQ.  
RHONDA L. CHING, ESQ.  
MORIHARA LAU & FONG LLP  
841 Bishop Street, Suite 400  
Honolulu, Hawaii 96813

1 copy  
by hand delivery

Counsel for KIUC

DEBORAH DAY EMERSON, ESQ.  
GREGG J. KINKLEY, ESQ.  
DEPUTY ATTORNEY GENERAL  
DEPARTMENT OF THE ATTORNEY GENERAL  
STATE OF HAWAII  
425 Queen Street  
Honolulu, Hawaii 96813

1 copy  
by hand delivery

Counsel for DBEDT

MR. HENRY Q CURTIS  
MS. KAT BRADY  
LIFE OF THE LAND  
76 North King Street, Suite 203  
Honolulu, Hawaii 96817

1 copy  
by U.S. Mail

MR. CARL FREEDMAN  
HAIKU DESIGN & ANALYSIS  
4234 Hana Highway  
Haiku, Hawaii 96708

1 copy  
by U.S. Mail

MR. WARREN S. BOLLMEIER II  
PRESIDENT  
HAWAII RENEWABLE ENERGY ALLIANCE  
46-040 Konane Place, #3816  
Kaneohe, Hawaii 96744

1 copy  
by U.S. Mail

DOUGLAS A. CODIGA, ESQ.  
SCHLACK ITO LOCKWOOD PIPER & ELKIND  
TOPA FINANCIAL CENTER  
745 Fort Street, Suite 1500  
Honolulu, Hawaii 96813

1 copy  
by hand delivery

Counsel for Blue Planet Foundation

MR. MARK DUDA  
PRESIDENT  
HAWAII SOLAR ENERGY ASSOCIATION  
P.O. Box 37070  
Honolulu, Hawaii 96837

1 copy  
by U.S. Mail

MIKE GRESHAM  
HAWAII HOLDINGS, LLC  
dba FIRST WIND HAWAII  
33 Lono Avenue, Suite 380  
Kahului, Hawaii 96732

1 copy  
by U.S. Mail

GERALD A. SUMIDA, ESQ.  
TIM LUI-KWAN, ESQ.  
NATHAN C. NELSON, ESQ.  
CARLSMITH BALL LLP  
ASB Tower, Suite 2200  
1001 Bishop Street  
Honolulu, Hawaii 96813

1 copy  
by hand delivery

Counsel for Hawaii Holdings, LLC, dba First Wind Hawaii

DATED: Honolulu, Hawaii, January 30, 2009.

A handwritten signature in dark ink, appearing to read "Jonathan H. Hui", is written over a horizontal line.